

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
ECONOMICALLY TARGETED INVESTMENT PROGRAM  
February 14, 2005**

*This policy is effective immediately upon adoption, and supersedes all previous economically targeted investment program policies.*

**I. PURPOSE**

This document sets forth the objectives and policy ("the Policy") for the [Economically Targeted Investment](#) Program ("the Program"). For purposes of this policy, an Economically Targeted Investment ("ETI") is defined as an investment which has collateral intent to assist in the improvement of both national and regional economies, and the economic well-being of the State of California ("the State"), its localities and residents. Economic stimulation includes job creation, development, and savings; business creation; increases or improvement in the stock of affordable housing; and improvement of the infrastructure.

The design of this Policy ensures that investors selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and capturing returns associated with this segment of the market.

**II. STRATEGIC OBJECTIVES**

- A. Providing competitive risk-adjusted rates of return while still promoting growth and development of the national and regional economies is the primary objective of the Program. The System's choices in ETIs will provide collateral benefits to targeted geographic areas, groups of people, or sectors of the economy while providing pension funds with prudent investments.
- B. Furthermore, prudent investment in ETIs creates jobs and housing, improves the general infrastructure, and serves the broad interests of the beneficiaries of the System. By strengthening the State's economy and the well being of employers, ETIs help promote the continued maintenance of employer contributions to the System.

- C. The Board will consider the secondary objective of promoting economic growth and well-being in the State and its localities when not in conflict with the Board's duties to the System of loyalty, care, skill, prudence, diligence and diversification. The emphasis will be on the promotion of long-term sustainable economic, industrial and business growth, job creation and affordable housing.
- D. All ETIs shall be consistent with Board's fiduciary obligations and approved investment policies and guidelines.

### **III. RESPONSIBILITIES AND DELEGATIONS**

- A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the Program to the Investment Staff through the Delegation of Authority (Delegation No. 89-13 and 95-50).
- B. **The CalPERS Investment Staff ("the Staff")** duties include, but are not limited to, the following:
  - 1. Developing and recommending the Policy to the CalPERS Investment Committee;
  - 2. Maintaining a procedures manual, which is subject to periodic review and updates, outlining Staff operational procedures used in implementing this Policy;
  - 3. Implementing and adhering to the Policy, and;
  - 4. Reporting immediately to the Investment Committee all violations of the Policy with explanations and recommendations.
- C. The **Consultant or Advisor** ("Consultant or Advisor") is responsible for due diligence consistent with the type of investment product and portfolio classification as delegated by the Staff.
- D. The **General Pension Consultant** (the "General Pension Consultant") is responsible for monitoring and evaluating the Program's performance relative to the applicable benchmark, as developed, and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.

### **IV. INVESTMENT APPROACHES AND PARAMETERS**

- A. The Board's constitutional duties, as defined and clarified by the recent amendments to California Constitution Article XVI, Section 17, take precedence over any other considerations. Any other considerations will be entertained only when not in conflict with any of these duties. It is recognized that investments made for the sole benefit of the System's beneficiaries may also generate collateral benefits.
- B. The System will consider only ETIs which, when judged solely on the basis of economic value, would be financially comparable to alternatively available investments. Comparability will be judged on a risk-adjusted basis with the System being willing to accept no less in return and incur no additional risk or cost.
- C. The collateral benefits shall not be considered part of the return to the System nor shall any improvement to the State's economy be considered part of risk reduction. The decision to choose the ETI in consideration of its broader benefits may occur only after the investment is deemed acceptable to the System exclusively on its economic investment merits.
- D. Any benefit an ETI may confer on other interests ("the target") is not the responsibility or within the ability or control of the System, but only of those who manage or are otherwise responsible for the target enterprise. This will be made expressly clear to third parties and the System's beneficiaries.
- E. For allocation purposes, ETIs will be included with similar investments that are free of economically targeted elements, and the combined assets will be subject to the Board's asset allocation guidelines, ranges, and targets. The goal for all assets in targeted areas shall be 2% of Fund assets. Investments shall not be made so as to alter the overall risk/return profile of the System's investments, which derives from the System's liability profile and funding level.
- F. ETIs shall not materially alter the System's approved asset allocation policies. Particular attention should be paid to the State's representation in the System's portfolio. The System's exposure to the State's economy, inclusive of investment in ETIs, at a minimum, shall generally be in line with the State's representation in the eligible investment universe and consistent with the Board's fiduciary obligations.
- G. ETIs must at all times conform to all the laws, requirements, policies and procedures governing the System.

- H. ETIs shall receive the proper level of due diligence consistent with the type of investment product and portfolio classification. This due diligence, to be conducted by staff, designated outside consultants or advisors, shall at a minimum address:
  - 1. Legal sufficiency;
  - 2. Identification of any potential conflicts of interest; and
  - 3. Investment Sufficiency – The standard for investment sufficiency shall be consistent with existing internal policies and practices of due diligence analysis for each specific asset type.
- I. The System may invest in ETIs so long as the Board has determined and can demonstrate that the investments properly discharge the Board's duties under the provisions of California Constitution, Article XVI, Section 17 (i.e., the duties of loyalty, care, skill, prudence, diligence and diversification) and are consistent with the California Government Code statutes applicable to the System (California Government Code sections 20000 et seq.). Consequently, all other economic objectives must necessarily be secondary to, and not impair, those duties imposed by the California Constitution and the System's statutes.
- J. Pursuant to the above criteria, consideration shall be given in order of preference to those investments which may benefit:
  - 1. Current and retired members of the System;
  - 2. Residents of the State;
  - 3. Enterprises that operate for the benefit, support, the employment of residents of the State; and
  - 4. Enterprises that address the economic and social need of the United States residents with unique major representation in the State.
- K. ETIs, whether in a stand-alone portfolio or incorporated with like investments which have no economically-targeted orientation, shall be priced at least at market prices and shall be subject to the applicable performance measurements.

**V. CALIFORNIA EMERGING MARKETS INVESTMENT POLICY**

**Strategic Objectives**

- A. The primary objective of California Emerging Market Investments is to achieve competitive risk adjusted rates of return while broadening economic opportunity in California's underserved areas. Consistent with this strategy, the objective of this policy is to discover and invest in opportunities that may have been bypassed or not reviewed by traditional, more mainstream sources of investment capital.
- B. Prudent investments in these markets will have the collateral intent of creating economic value and activity in underserved markets, thereby contributing to the well-being of the California economy. By strengthening the State's economy and the revenue base of the State of California, these investments will also serve the broad long-term interests of the beneficiaries of the System.
- C. All California Emerging Market Investments shall be consistent with the Board's overall fiduciary obligations and approved investment policies and guidelines, including the Board's Economically Targeted Investment Policy.

**General**

- A. **Definition:** California Emerging Market Investments shall focus on investment opportunities in traditionally underserved markets located in California. By way of example, underserved markets would include urban and rural areas undergoing or in need of revitalization where there are assets (e.g. an available labor pool, underutilized infrastructure) conducive to business development. The Definition of California Emerging Markets Investments is appended as Exhibit 1.

**Investment Goal**

- A. The goal for California Emerging Market Investments shall be 2% of CalPERS's total investment portfolio. At such time as the 2% goal is achieved, the Board shall evaluate whether to increase the goal.
- B. For allocation purposes, California Emerging Market Investments will be included with similar investments in asset classes including fixed income, private equity, and real estate.
- C. Staff shall monitor investments made under this policy and the General Pension Consultant shall report annually to the Board on

investment performance as well as identification of assets committed, invested, and [recycled](#) under this policy.

### **Investment Approach and Parameters**

- A. The Board's constitutional duties in California Constitution Article XVI, Section 17, take precedence over any other considerations. Any other considerations will be entertained only when not in conflict with any of these duties. It is recognized that while investments are made for the sole benefit of the System's beneficiaries, collateral benefits may also result.
- B. The collateral benefits shall not be considered part of the return to CalPERS nor shall any improvement in California Emerging Markets be considered part of risk reduction. The decision to invest in underserved markets and consideration of its broader benefits may only occur after the investment is deemed acceptable to the fund exclusively on its own economic investment merits.
- C. California Emerging Market Investments shall receive prudent level of due diligence, to be conducted by staff, designated outside advisors or consultants, consistent with the Board's Economically Targeted Investment Policy. As part of this due diligence, staff shall consider the current economic condition of the State of California and the prudence of committing assets to underserved areas given that economic condition.
- D. California Emerging Market Investments, whether in a stand-alone portfolio or incorporated with like investments which have no emerging market-targeted orientation, shall be priced at least at market prices and shall be subject to the applicable performance measurements.

## **VI. GENERAL**

- A. A consistent and methodical means of evaluating all ETI opportunities is of paramount importance. ETIs are not uniform in structure, method, or objective. Consequently, a policy to evaluate the risk, return, and liquidity characteristics must be established to assure that these investments are comparable on a risk/return basis with more traditional opportunities and are consistent with the financial requirements of the System.
- B. The lack of homogeneity of ETIs, likewise, makes these instruments difficult to market on a large-scale basis. Each ETI shall be

separately evaluated based on its unique structure and potential in accordance with the System's investment criteria and this Policy. This will ensure that all the System's responsibilities and investment requirements are being addressed in the evaluation and investment process.

- C. The existence of this Policy shall not be construed as a mandate to invest in ETIs, but rather should be viewed as an additional set of suggested parameters within which to consider such investments.

## **VII. GLOSSARY OF TERMS**

The Miscellaneous Glossary of Terms is referenced in the System's Master Glossary of Terms.

**Exhibit 1****California Emerging Markets****Definition of California Underserved Communities Investment**

California Underserved Communities would include urban and rural areas undergoing or in need of revitalization where there are assets (e.g. an available labor pool, underutilized infrastructure) conducive to business development. For example, an eligible investment would include:

- Equity or debt investments in –
  - Companies with substantial business operations in an underserved urban or rural area.
  - Real Estate (office, retail, housing, industrial) located in an underserved urban or rural area.
- Community Redevelopment Act (CRA) eligible investments
  - Assets comprised significantly of loans made to borrowers with annual income less than 80% of the adjusted median income for the Metropolitan Statistical Area (MSA).
  - Assets comprised significantly of loans made in low to moderate income census tracts which are defined as those census tracts where the median income is less than 80% of the MSA in which the census tract resides.

Examples of potential investments include but are not limited to:

- An equity or debt investment in a retail chain that needs expansion capital to penetrate an inner city area to capture untapped purchasing power and growth opportunities.
- An equity or debt investment in a manufacturing operation that needs capital to build a facility in a low income, rural Enterprise Zone to access middle skilled workers.
- An equity or debt investment in a distribution company that takes advantage of lower cost, underutilized inner city real estate to lower costs and locate closer to customers and transportation networks.



- An equity or debt investment in companies to finance back office operations located in areas with an underemployed, available labor pool.
  - An equity investment in a private equity fund that targets debt and equity investments in companies/real estate in underserved areas.
  - An equity or debt investment in a mixed use urban development real estate project.
  - An investment in CRA eligible single family or multi-family mortgage pools.
  - An investment in commercial mortgages that are CRA eligible.
  - An investment in Small Business Administration Loans that are CRA eligible.
- New investments in the marketplace that have not yet been identified` 1